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Habib Investment Limited

Views from the desk

Monthly Global Market Overview and Outlook

Habib Investment Limited
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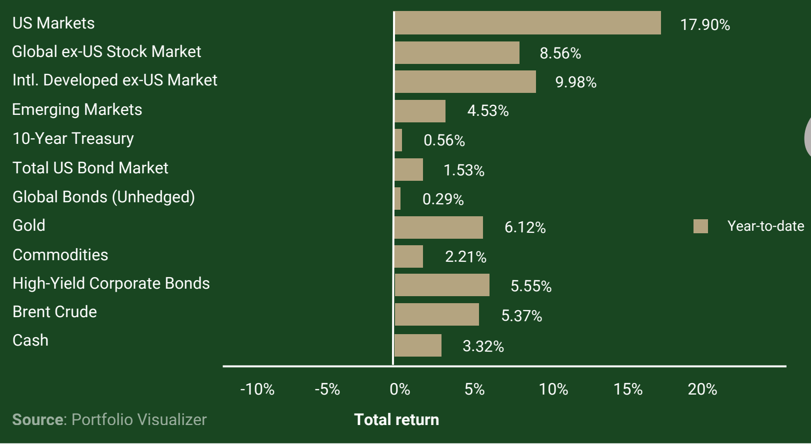
Oil , Inflation, Disinflation & Inclusion

The rise and rise of everything including risk

Assets in review
Selected asset performance, 2023 year-to-date return and range



Source: Portfolio Visualizer

Macro Overview

In the bull market, Investors only see opportunities and are blind to risks. It's the opposite in bear markets"

— Sandeep Jadwani | ACSI
Head of Investment Advisory

In 2023, the concentration within the S&P 500 has been a prominent theme. However, two noteworthy conclusions can be drawn when considering the remaining index constituents and international markets.

Firstly, the median stock within the S&P 500 has seen a modest 5% increase in performance. This implies that there may still be attractive entry points available within the index for investors.

Secondly, the performance of the largest stocks in Europe and Japan closely aligns with their respective benchmarks. This suggests that U.S. investors may discover a more balanced return profile by exploring opportunities abroad.

In the final quarter, the credit market confronts a stern test as the Federal Reserve's shift toward higher interest rates challenges the concept of a gentle economic landing. This shift has caused credit spreads, both in the high-yield and investment-grade sectors, to widen notably, prompting corporate executives to grow increasingly anxious about the economic trajectory. Notably, corporate defaults are on the rise, with projections indicating a potential 4% default rate for 2023, with little relief expected in 2024.

The market also remains concerned about a looming U.S. government shutdown, which could affect data releases and Federal Reserve decision-making. Rising interest rates are taking a toll on high-flying tech stocks, with short positions on the Nasdaq 100 Index increasing.

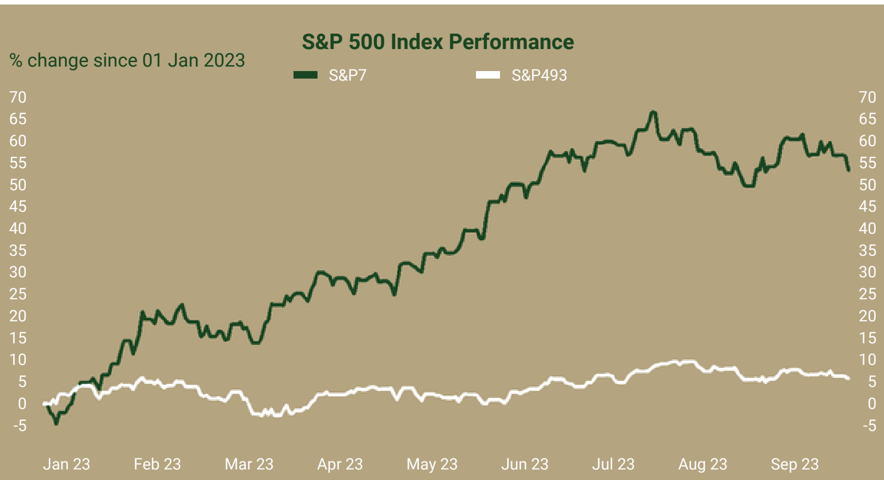
Meanwhile, China's property market woes and volatile oil prices add further complexity to the global economic landscape, creating a challenging environment for investors and traders alike.

In conclusion, the credit market is facing a challenging period characterized by uncertainty and shifting dynamics. As investors and traders navigate these treacherous waters, they must keep a close eye on the evolving situation and adapt their strategies accordingly. The Fed's monetary policy decisions and the economy's ability to maintain stability in the face of higher rates will be key determinants of market performance in the coming months.

1. Credit markets face a challenging Q4 as the Fed's hawkish stance challenges the notion of a soft landing.
2. Rising credit spreads and corporate defaults raise concerns, with defaults projected to reach 4% in 2023.
3. The market is wary of a potential U.S. government shutdown and the impact of rising interest rates on tech stocks.
4. China's property market woes and oil price volatility add further complexity to the global economic landscape.

'Scary September'

The Scary Season we all hope is just Halloween



Concentration Risks Creates Diversified Opportunities

In 2023, the concentration within the S&P 500 has been a prominent theme with S&P7 up more than 50% and S&P493 is basically flat.

Global Outlook

While some indices showed resilience, the overall sentiment was marked by volatility and uncertainty. The FTSE 100 emerged as the standout performer in September, showing a 2.5% gain by month-end. This positive trend was attributed to lower reported inflation figures, which provided a boost to market sentiment.

However, for most equity markets, it was a challenging month. Bond yields continued their upward trajectory, with the US 10-year Treasury yield surpassing the psychologically significant 4.5% level (*the highest in 16 years*). Additionally, concerns about the US economy deepened as reports of home sales falling short of expectations and declining consumer confidence surfaced. The numbers painted a sobering picture, with 675,000 homes under contract reported for the month, an 8.7% drop from July. The consumer confidence index also declined to 103 in September, further fueling apprehension.

These factors collectively weighed on investor sentiment, leading to a significant drop in major US indices. The S&P 500, Nasdaq, and Dow Jones all ended the day at three-month lows. Notably, the Dow Jones experienced its worst day since March, while the S&P 500 breached the 4,300 level for the first time since June. The Nasdaq 100 was also impacted, particularly due to the struggles of tech giants like Amazon, which faced an antitrust lawsuit.

Despite the challenges, market equity analysts maintain that the secular bull market is still intact. While it is anticipated for a continued weakness until mid-October in line with seasonal patterns, there could be a potential resurgence towards the year-end.

Focus on India: India continues to be a focal point for investors. JPMorgan's decision to include Indian government bonds in a prominent emerging market index marked a significant development. This move is expected to channel substantial investments into Indian government bonds, bolstering the country's financial position. Both Indian government bonds and the Indian rupee responded positively to this news.

Moreover, India's population growth and robust economic performance make it an attractive investment destination. The International Monetary Fund (IMF) anticipates India's economy to grow by approximately 6.1% this year, surpassing other major economies.

China's Property Sector Woes: China's property sector has been under scrutiny due to its heavy debt burden. Evergrande, one of the sector's leading companies and the world's most indebted, faces increasing challenges. The company's inability to issue new debt for restructuring, coupled with regulatory investigations, has sent shockwaves through the market.

China still has policy tools and reserves to stabilise residential sales in countries largest cities.

Hawkish US Federal Reserve: The US Federal Reserve adopted a hawkish stance, emphasizing the need to maintain higher interest rates for an extended period. Although the Fed left interest rates unchanged, voting members foresee one more rate hike this year. This shift in sentiment has started to manifest in the market, with expectations of the Fed keeping rates above 5% next year.

Despite these developments, the Fed remains cautious, leaving room for two rate cuts next year. The economic landscape is dynamic, and the Fed is keen on sustaining 'solid' economic activity while monitoring inflation trends, including the impact of higher oil prices.

Swiss Central Bank's Decision: The Swiss National Bank (SNB) surprised the market by refraining from raising interest rates, citing sufficient measures already taken to counter inflationary pressures. Despite this decision, the SNB highlighted global economic risks, such as persistent inflation in some countries and potential energy-related challenges in Europe.

The SNB's choice was welcomed by equities, particularly export-oriented Swiss companies, which had been grappling with a strong Swiss Franc (CHF). This decision may provide some relief after months of currency strength.

Bank of England's Rate Decision: In a closely watched move, the Bank of England decided to keep interest rates at 5.25%, ending a streak of 14 successive rate hikes. The decision was a close call, with five members of the Monetary Policy Committee voting against a rate hike. This decision prompted a relief rally in UK equities, with banks and property companies among the beneficiaries.

Despite keeping rates unchanged, the Bank of England emphasized the importance of maintaining a restrictive monetary policy to address inflationary concerns.

Bank of Japan's Monetary Policy: The Bank of Japan (BoJ) maintained its ultra-easy monetary policy, leaving rates at -0.1% and capping the yield on 10-year government bonds at zero. BoJ Governor Kazuo Ueda underscored the need for such a policy until Japan reaches its 2% inflation target.

The market's reaction was mixed, with the Japanese yen weakening against the US dollar while Japanese equities faced some declines. The Governor's stance did not provide clear signals regarding future policy changes.

Market Implications: As a result of the Fed's stance, US bond yields surged, with the 2-year US Treasury yield reaching its highest level since 2006 at 5.18%. The market consensus points to the 10-year US Treasury yield approaching 4.5%. This surge in yields, coupled with the anticipation of continued high borrowing costs, put pressure on equities.

The Nasdaq experienced the most significant losses among major indices, falling over 1.5%. However, the VIX index, a measure of fear in US large-cap equities, remained relatively low, indicating that investors are not overly concerned. This reaffirms our perspective that setbacks in US equities can present opportunities for gradual exposure building.

Fixed Income Considerations: Investors in US government debt have experienced three consecutive years of losses. The volatility in fixed income markets, driven by the 'normalization' of monetary policy and unexpected rises in the US budget deficit, has challenged expectations.

Nevertheless, high-quality and longer-dated bonds denominated in US dollars present attractive opportunities, given the current yield levels and expectations of a stable monetary policy.

Selecting Equity Opportunities: Amidst market turbulence, certain sectors hold promise. Defensive sectors, particularly healthcare, have demonstrated resilience due to their stable cash flows and demand even in challenging economic times. Healthcare companies also offer innovation potential, making them a compelling portfolio addition.

Moreover, profitable growth stocks remain appealing, especially in a higher financing cost environment. The importance of focusing on companies with strong profitability and cash flow is emphasized.

As earnings releases get under way next month, we will watch and listen to what CEOs have to say about the future. If they see an earnings rebound that ends the earnings recession this quarter, then maybe we can pull off this soft landing. However, if they are still seeing earnings weakness, with oil prices and a strong dollar taking the place of inflation as the bogeyman, we should anticipate another quarter of poor earnings. After such a long succession of earnings declines dating back to the fourth quarter of last year, investors should not just give up hope for a soft landing, they should expect a recession to cause shares to drop then too.

Market Definitions 101

No Landing

When the economy continues to grow above normal while the unemployment rate stays low, the markets remain tight and inflation cools down to it's targeted rate.

Soft Landing

The slowing down of economic growth at an acceptable degree relative to inflation and unemployment.

Hard Landing

An economy rapidly shifting from growth to slow-growth to flat as it approaches a recession, usually caused by government attempts to slow down inflation.

Asset Class Views

Asset Class	Sub-Class	View (Aug'23)	View (Sept'23)
Main Asset Class	Equities	=	=
	Fixed Income	=▲	=▲
	Commodities	=▲	=▲
	Currencies	=▲	=▲
Equities	USA	=	=
	EU (Ex UK)	=▲	=
	Japan	▲	▲
	UK	=	=
	EM (Ex MENA)	▲	=
	MENA	=▲	=▲

Asset Class Views

Asset Class	Sub-Class	View (Aug'23)	View (Sept'23)
Fixed Income	US Treasuries	=	=
	Euro (Bunds)	▼	▼
	UK Gilts	▼	▼
	US IG	=▲	=▲
	US HY	=	=
	Europe IG	▼	▼
	EM	=	=
Commodities	Oil	=	=
	Precious Metals	=▲	=
Currencies	USD	=	=▲
	EUR	=	=
	GBP	=	=
	EM	=	=

▲ overweight = neutral weight ▼ underweight ■ negative tilt ■ positive tilt

Critical Future Events

Oct 16: ECB Meeting

Nov 2: BoE Meeting

Oct 31: BoJ Meeting

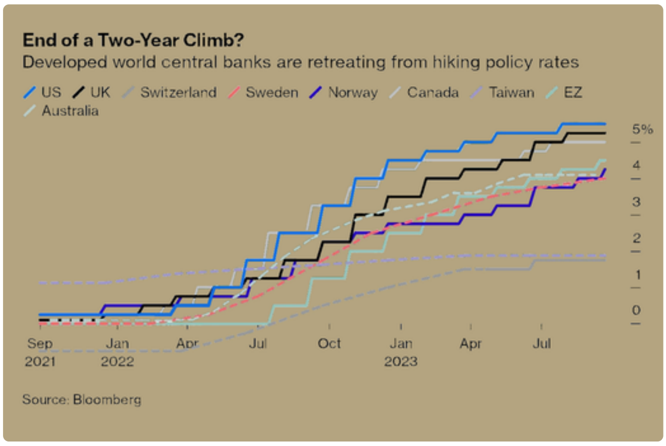
Nov 2: FOMC Meeting

A Number of Opportunities Emerging

on Both the Long and Short Side across Equity and Fixed income

In a recent speech, Huw Pill, the Chief Economist at the Bank of England, introduced a novel analogy for monetary policy – the "Table Mountain" scenario. The flat peak, proposes that interest rates should reach a plateau and remain at that level for an extended period of time. Unlike the steep ascent of a mountain peak scenario, rates in the Table Mountain analogy wouldn't need to climb as high, but they would persist at this elevated plateau for an extended duration.

In a broader context, this month's central bank meetings around the world (as mentioned above) have signaled a common desire among central banks to reach a plateau in their rate policies. While the Bank of Japan, as a perennial exception, left rates unchanged, others have taken noteworthy steps. Both the Swiss National Bank and the Bank of England surprised observers by choosing not to raise rates at all. The European Central Bank, during its recent meeting, did implement a rate hike but also made concerted efforts to convey that it might be the last for a while. Sweden's Riksbank raised rates to 4% but emphasized that its mission had been accomplished. This collective stance suggests that perhaps, in the metaphorical sense, we have scaled the summit of Table Mountain. The analogy holds even better when you consider that mountains with a flat top, akin to Table Mountain, are relatively rare, while triangular peaks are more common.



In a notable development, during Asian trading, the 10-year Treasury yield reached 4.5% for the first time since the eve of the Global Financial Crisis in 2007.

This is a milestone that market participants will undoubtedly notice. Whenever conditions tighten to this extent, a recession typically looms on the horizon. When a recession does occur or when high rates lead to the much-feared financial catastrophe, rates tend to plummet dramatically, resembling the sheer cliffs off a plain.

A closer examination of the increase in yields reveals that it signifies a genuine tightening of conditions. The 10-year yield can be dissected into a component that covers expected inflation (the breakeven rate) and a residual "real yield." The former responds to concerns about inflation, while the latter serves as the driving force determining whether conditions are genuinely tight. Interestingly, the majority of this year's yield movement can be attributed to higher real yields, while concerns about inflation have somewhat subsided. The latest surge is widely attributed to Jerome Powell of the Federal Reserve, whose remarks indicate that the Fed's projections imply an economy with "more underlying momentum than previously believed" and a reduced need to excessively restrain the job market to rein in inflation by 2026.

Consequently, the Fed's "bullishness" is putting upward pressure on rates. Unless and until the Fed succeeds in "breaking something" – whether a major institution or the broader economy – yields are likely to continue their ascent into the stratosphere. This mountain analogy offers an insightful perspective on the intricate dynamics of monetary policy. Central banks, much like climbers descending from a peak, must exercise caution as they guide economies down from the heights of monetary tightening, aiming to avoid economic avalanches and financial pitfalls along the way.

Source and Sighting: BJSS, Bank of America, Bloomberg, Nomura, JB, Goldman Sachs Asset Management, HSBC, Wikipedia (definitions)